No._____

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

LONGHORN PORTLAND CEMENT COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

SAN ANTONIO PORTLAND CEMENT COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Facts

The facts have been stated in the petition in summary form. The facts were developed before The Tax Court by oral testimony and documentary evidence, and as found by The Tax Court were as follows:

The petitioners are Texas corporations and during all the time material hereto were engaged in the manufacture and

sale of cement, each having a gross sales for the year 1939 of approximately $2,000,000 (R. 39).

During the taxable year (1939), each of the petitioners paid the State of Texas $50,000 in compromise of a suit by the State in which the petitioners were defendants. The suit was docketed in the District Court of Travis County, Texas, and was captioned "STATE OF TEXAS v. SAN ANTONIO PORTLAND CEMENT COMPANY, ET AL." (R. 39).

The suit referred to was one in which the State alleged that the defendants had violated the anti-trust laws of the State of Texas in various respects set out in great detail in the petition. By this suit, the State sought to recover statutory penalties provided by Articles 7426-7447, inclusive, REVISED CIVIL STATUTES (1925), in amounts from $50 to $1500 per day from January 1, 1930, to the date of the filing of the suit, September 21, 1939 (minimum amount claimed from each petitioner $177,450, maximum $5,323,500), and a further judgment cancelling and forfeiting the charters of the defendants, establishing and foreclosing a lien given by the above cited law against the property of the defendants, and enjoining and restraining each of the defendants from carrying out alleged agreements, conspiracies, trusts and combinations and for other general and special relief (R. 39-40).

The answer of each of the petitioners to said suit consisted of a general demurrer, a general denial, and a special denial that any acts, methods or practices used in its business were used as a result of, or pursuant to, any agreement or any unlawful purpose. No evidence was ever taken in said suit (R. 40).

The officers and directors of the petitioners were advised by their respective counsel that they had a good defense, but they were induced to and did compromise said suit, and

each paid the sum of $50,000 to the State because of the following considerations:

(a) Petitioners were convinced that it would cost less to settle the suits than the expense of carrying the litigation to an end, even though entirely successful in such litigation.

(b) Business would be disrupted over a long period of time through the necessary attendance of officers at the hearings.

(c) Unfavorable publicity would result from the newspaper reports of the trial, which would have a damaging effect upon their businesses.

(d) The injunctive relief sought by the State would not prevent them from carrying on business in the usual manner so long as the petitioners did not enter into an agreement with one another or with any competitor regarding prices and practices (R. 40).

The parties to said suit thereupon entered into a stipulation of facts which contained an express denial by the petitioners of the acts as charged in the petition, and Section III of said stipulation read as follows:

> "This agreement is made by the parties hereto solely and only for the purpose of compromising and settling the matter involved in this suit by and between the State of Texas, as plaintiff, and the defendants named herein, and it is expressly understood and agreed as a condition hereof, that neither this agreement nor the judgment to be entered thereon, nor any clause or provision of said agreement or judgment, shall constitute or be construed to be an admission or estoppel as against the various defendants herein as evidencing or indicating in any degree an admission of truth or correctness of the allega-

tions in plaintiff's petitions contained in whole or in part" (R. 42).

With the stipulation of the parties before it, the Court rendered a judgment on December 15, 1939, and after specifically reciting in detail the agreement of the parties in the compromise of said suit, the judgment provided in part as follows:

> "And it appearing to the Court that said agreement is proper and in keeping with the law in such cases made and provided, and that same should be approved, and that final judgment should be entered in keeping therewith, it is:
>
> "FIRST
>
> "THEREFORE, ORDERED, ADJUDGED AND DECREED that the agreement heretofore entered into between the parties to this cause be and the same is hereby in all things approved.
>
> "SECOND
>
> "IT IS FURTHER ORDERED, ADJUDGED AND DECREED that plaintiffs, the State of Texas, have and recover of and from the defendants, San Antonio Portland Cement Company and Longhorn Portland Cement Company, jointly and severally, the sum of One Hundred Thousand ($100,000.00) Dollars in full satisfaction of all claims of the State of Texas for penalties for the alleged violations of law set out in Plaintiff's Original Petition, and in full satisfaction of all expenses of the Attorney General in investigating, instituting and preparing this cause for trial; and all costs of suit are hereby adjudged against the defendants, San Antonio Portland Cement Company and Longhorn Portland Cement Company, jointly and severally, * * * " (R. 41).

The judgment rendered contained no expression or indica-

tion of a determination that the petitioners had violated the anti-trust laws of the State of Texas, or any provision thereof (R. 42).

In their Federal income and declared value excess profits tax returns for the taxable year 1939, the petitioners each deducted the $50,000 paid to the State of Texas as an ordinary and necessary business expense. In his notices of deficiencies for the taxable year 1939, the Commissioner of Internal Revenue determined that said payments were not ordinary and necessary business expenses within the purview of Section 23 (a) (1) (A) of the INTERNAL REVENUE CODE and were not allowable deductions (R. 17).

The Tax Court sustained the petitioners' contention and found that said amounts were directly connected with the business carried on by each of the petitioners, were ordinary and necessary expenses paid or incurred in the carrying on of said trade or business, and did not frustrate public policy. Accordingly, the Tax Court determined that the payments were allowable deductions (R. 38).

Argument

1.

The decision by the Circuit Court of Appeals conflicts with the principles announced by this Court in Dobson v. Commissioner, 320 U.S. 489, and has so far departed from the accepted and usual course of judicial proceeding on review as to call for an exercise of this Court's power of supervision.

Stripped of all but its essentials, the question here involved is whether the payment of $50,000 made by each of the petitioners in 1939 to the State of Texas is to be characterized

as a *penalty* payment. The determination of the *fact* as to whether such payment is or is not in the nature of a penalty will carry with it the determination of whether the payment is or is not an allowable deduction to the petitioners for Federal income tax purposes in the year 1939. On this bare question, the Tax Court, in the exercise of its own independent judgment of the facts (compare COMMISSIONER v. HEININGER (1943), 320 U.S. 467; the last paragraph of the opinion in the case of HORMEL v. HELVERING (1941), 312 U.S. 552), found that the payment was not and could not be construed to be a penalty payment or characterized as such. In contrast therewith, the Circuit Court states that it recognizes these facts as found by the Tax Court, but proceeds to arrive at its determination on a factual premise that refutes the Tax Court's finding. In other words, the Circuit Court states that an amount paid to extinguish a claim or cause of action to impose a penalty must have been a penalty payment. This reversal of a fact essential to its determination is the error by the Circuit Court here claimed by the petitioners.

It is not deemed necessary to do more than point out the rule already announced by this Court in DOBSON v. COMMISSIONER (1943), 320 U.S. 489, reemphasized in such cases as COMMISSIONER v. HEININGER, supra; COMMISSIONER v. SCOTTISH AMERICAN INVESTMENT COMPANY (1944), 323 U.S. 119, and COMMISSIONER v. COURT HOLDING COMPANY (March 12, 1945), 89 L. Ed. 661, as to the relative positions and functions of The Tax Court and the Circuit Courts of Appeals with respect to questions of fact and identification of clear-cut mistakes of law. (Compare BINGHAM, ET AL., v. COMMISSIONER, supra). This part of the brief will therefore serve its purpose and the error of the Circuit Court will be apparent if it can be successfully demonstrated that no issue but a question of fact is involved and that the decision of the Tax Court does not contain an identifiable or clearcut mistake of law.

In the first place, there is no statute condemning payments incident to a penalty suit as non-allowable expense items. The question of non-allowance has arisen out of principles of public policy. Whether, in any given situation, public policy requires non-allowance, is essentially and fundamentally a question of fact. There are no differences between the decisions of the Tax Court, the Circuit Courts and this Court as to the established rules regarding the deductibility for Federal income tax purposes of amounts expended in successful defenses of alleged violations of law* as compared to circumstances where convictions, pleas, or established violations resulted in the payment of fines, penalties and expenses.** Had the Tax Court found that the payments were penalties it would have been bound under the doctrine of stare decisis to deny deductibility. The holding that the payments were deductible is proof that the Tax Court did not consider them to be penalty payments. Once the character

---

* **Kornhauser v. The United States** (1928), 276 U.S. 145; 89
National Outdoor Bureau v. Helvering (C.C.A. 2, 1937), 89 F. (2d) 878;
Commissioner v. People's-Pittsburgh Trust Company (C.C.A. 3, 1932), 60 F. (2d) 187;
Commissioner v. Continental Screen Company (C.C.A. 6, 1932), 58 F. (2d) 625;
Hal Price Headley (1938), 37 B.T.A. 738;
Citron-Byer Company (1930), 21 B.T.A. 308;
H. E. Bullock (1929), 16 B.T.A. 451.

** **Standard Oil Company (and affiliated Subsidiaries) v. Commissioner** (C.C.A. 7, 1942), 129 F. (2d) 363, cert. denied 63 S. Ct. 261;
Helvering v. Superior Wines & Liquors, Inc. (C.C.A. 8, 1943), 134 F. (2d) 373;
Burroughs Building Material Company v. Commissioner (C.C.A. 2, 1931), 47 F. (2d) 178;
Great Northern Railway Company v. Commissioner (C.C.A. 8, 1930), 40 F. (2d) 372, cert. denied 282 U.S. 855;
Columbus Bread Company (1926), 4 B.T.A. 1126;
Bonnie Brothers, Inc. (1929), 15 B.T.A. 1231.

of the payments is determined, i.e., whether it is paid for a successful defense, for a fine or penalty established in fact, the rule for the allowance as a deduction is clear. But as stated in the Tax Court opinion:

> "The present situation falls between these two lines of authorities."

With the foregoing rules before it, The Tax Court went to great length to carefully analyze the *facts* surrounding the instant payments, including the facts (1) that on its face the judgment entered in the local court recited that a payment was being made "in full satisfaction of all claims of the State of Texas for penalties for the alleged violations of law set out in Plaintiff's Original Petition, and in full satisfaction of all expenses of the Attorney General in investigating, instituting and preparing this cause for trial," (2) that such portion of the judgment must be read in the light of the surrounding circumstances, (3) that the allowance of the payments as deductions would not frustrate "sharply defined national or state policies prescribing particular types of conduct"*, (4) the considerations which prompted the petitioners to enter into the compromise of the suit, and (5) since the State of Texas itself, by reason of the stipulation of the parties was in no position to infer or maintain that a violation had occurred, The Tax Court itself could not so find. In the light of all these facts, The Tax Court found that the payments carried no brand as penal in nature and fell within the rule which would allow the payments as deductions.

To all of these facts considered by The Tax Court, the Circuit Court replied by determining that although recognition was accorded thereto, the penalties were nevertheless

---

* **Commissioner v. Heininger**, supra.

penal in nature because they had been made to extinguish a cause of action to impose a penalty. It is obvious that the conclusion by the Circuit Court is based upon a fundamental *difference of fact* from the conclusion by the Tax Court. Furthermore, if the Circuit Court reasoning is sound for the conclusion reached, it would do violence to the established rule for deductions following successful defenses of causes of action which charged defendants with violations of law. It would be just as logical (following the Circuit Court's reasoning) to say that amounts expended in the *successful defense* of alleged violations of law were in reality amounts paid to extinguish a cause of action to impose a penalty. This determination would fix their character as non-deductible expenditures.

The cases cited by the Circuit Court in its opinion to support the principle regarded as requiring a reversal of The Tax Court decision do not support in fact the principle announced by the Circuit Court in its instant opinion.

In UNITED STATES v. JAFFRAY (C.C.A. 8, 1938), 97 F. (2d) 488, the amount of a penalty was compromised, there being no question of the *fact* of the *existence* of the penalty. In the JAFFRAY case, supra, the payment was not made to extinguish a cause of action to impose a penalty, but rather was made in satisfaction of a recognized, existing penalty.

In STANDARD OIL COMPANY v. COMMISSIONER, supra, a consent decree, with its surrounding circumstances, established the guilt of the parties involved. The Board of Tax Appeals (now The Tax Court), found as a fact that the transaction which resulted in said payment, was *mala fides* and fraudulent, and thereby established beyond doubt the *nature* of the payment.

In HELVERING v. SUPERIOR WINES & LIQUORS, INC., supra, the taxpayer successfully abated the amount of an alleged violation by contending that such violations were due to

"ignorance of regulation and procedure," for which reasons an offer in compromise was made. (Compare with reasons for compromise here.) However, the fact that the taxpayer there had committed the violation was not open to doubt and the rule in the JAFFRAY case, supra, was held to apply. (The status or authority of SUPERIOR WINES, supra, is in doubt since HEININGER v. COMMISSIONER, supra.)

Opposed to the established fact of a violation in each of the three cases commented upon above, the instant proceedings show no such fact, but rather, by the stipulation of the parties that the payments shall in no way be construed as an admission of guilt or against interest, there is established the absence of such factor, which compelled The Tax Court to its conclusion. It is this essential fact which the Circuit Court has overlooked in an attempt to apply a principle of law and thereby avoid the obligation with respect to the finality of The Tax Court's findings on questions of fact.

Finally, although every case of this type must, in a sense, stand on its own facts, if the two tests outlined in the HEININGER case, supra, are applied, the Circuit Court has departed from the accepted and usual course of judicial proceeding on review, and the exercise of this Court's power of supervision is in order. Test one of the HEININGER case, supra, is the relation of the expenditure to the taxpayer's business. The finding by The Tax Court that the expenditure was directly connected to the operations of the petitioner's business was not disturbed by the Circuit Court. Test two is whether the payment frustrates "sharply defined national or state policies proscribing particular types of conduct." As a guide to the application of this test, this Court said in the HEININGER case:

> "It has never been thought, however, that the mere fact that an expenditure bears a remote relation to an illegal act makes it non-deductible."

With respect to test two, The Tax Court found as a fact, and with evidence to support such finding, that the payment by the petitioners did not frustrate sharly defined policies of the State of Texas proscribing combinations or agreements in restraint of trade. The Circuit Court held that public policy must have been frustrated because in its opinion the payments were penal in character. Thus, throughout its opinion, the Circuit Court is unable to lift the payments out of the penal category and reach the fact as found by The Tax Court that the facts showed the payments to be not penal or in lieu of penalties. Therefore, the rule of law announced by the Circuit Court was applied to a set of facts at variance with the facts found by The Tax Court.

2.

The Circuit Court of Appeals has decided a question of importance to the administration of Federal law which has not been, but should be settled by this Court.

The question of whether amounts paid in compromise of an asserted claim for penalty for a violation of a State or Federal statute where the violation is neither admitted nor established, and where the motivation for the settlement of the claim is for reasons other than certainty of guilt or fear of conviction, are permissible deductions has not been decided in any case other than that sought to be reviewed herein. It is an important question of Federal law because of the number of wartime measures which are implemented by sanctions that amounts paid or collected in contravention of statutory regulations shall not be allowed as an ordinary and necessary business expense for Federal income tax purposes. See Section 4001.10 of the regulations of the Economic

Stabilization Director issued October 27, 1942, and Section 904.5 of Regulation No. 4 of the Chairman of the War Manpower Commission effective April 18, 1943, as amended October 20, 1944, 9 FEDERAL REGISTER No. 210, page No. 12672; and because of emergency statutes which provide for civil penalties for violations of regulations issued thereunder, which are subject to honest dispute in interpretation, such as the Emergency Price Control Act, 56 Stat. 23. It is probable that many taxpayers have made compromises of claims asserted for alleged violation of these and similar statutes and statutory regulations under circumstances similar to the compromise payment made by the taxpayer in this case. It is probable also that other taxpayers are now contemplating the making of such compromises, dictated by such considerations. The importance of this question of Federal law, presently undecided by this Court, to such taxpayers is obvious.

The Circuit Court of Appeals has erroneously decided this important question of Federal law. It has decided it on the erroneous proposition that any compromise payment which extinguishes a cause of action to impose a penalty is a payment as a penalty. See earlier comments on cases of JAFFRAY, STANDARD OIL COMPANY and SUPERIOR WINES & LIQUORS, INC., supra.

The Tax Court's reasoning reaches the proper result in this case. "Financially the petitioners were convinced that it would cost more to litigate the suit even though they received a favorable verdict. Economically the injunction would not prevent them from carrying on their business so long as they did not act under an agreement with competitors as to the conduct thereof. Actually the disruption of their business because of the absence of their officers and key men in their organizations plus the unfavorable publicity attendant upon the trial might be more damaging to each of the petitioners than the amounts of the compromise pay-

ments. Since taxation is a practical matter, the practical aspects of a tax problem should be faced and considered in determining tax liability. * * * Our view is that under all the facts and circumstances, the attorney's fees, the related expenses, and the compromise payments were ordinary and necessary expenses paid in carrying on petitioner's respective business and we so hold."

3.

The decision by the Circuit Court of Appeals is in conflict with the weight of applicable authority pertaining to the regard to be accorded compromise settlements.

The last reason stated for granting the writ digs deeply into what are deemed fundamental concepts of law which the Circuit Court, in viewing these procedures in the narrow field of taxation, has lost sight of.

It is essential to this phase of the argument to keep in mind that under the facts here present, no violation of law or guilt on the part of the petitioners has been established or can be inferred. In the absence of such fact or the right to draw inferences, can a conclusion be made, as did the Circuit Court, that because a compromise was reached, the effect is the same as though such fact or inference did exist?

It has long been established as a sound principle of public policy that settlements of disputed claims are to be favored and no inference or conclusion should be drawn therefrom. 20 AM. JURIS. 477, 11 AM. JURIS. 249. In 15 C. J. S. 737, it is stated:

> "The compromise and settlement of a claim or cause of action is not an admission that the claim is valid, but

> merely admits that it is a dispute, and that an amount is paid to be rid of the controversy; * * * "

See also 31 C. J. S. 1040; WIGMORE ON EVIDENCE, Vol. 4 (3rd Ed.), page 28.

Contrasted with the above rule, the Circuit Court, in its opinion, stated that as applied in the field of taxation such a compromise payment could only be regarded as a penalty payment and on that basis an unallowable deduction. Instead of drawing the inference that the payments were in lieu of penalties, it might be just as logical to draw the opposite inference. The Tax Court found, with facts to support such finding, that the payments were made for business considerations heretofore recited and therefore allowable deductions. In the case of WEST v. SMITH (1879), 101 U.S. 263, 273, this Court stated:

> "By all or nearly all the cases, the rule as established is not that an admission made during or in consequence of an effort to compromise is inadmissible, but that an offer to do something by way of compromise, as to pay sums of money, allow certain prices, deliver certain property, or make certain deductions, and the like, shall be excluded. These cannot be called admissions, as they were made to avoid controversies and to save the expenses of vexatious litigation."

The Circuit Court was obviously swayed in its decision by the recital in the stipulated judgment by the local state court to the effect that the amounts paid were "in full satisfaction of all claims of the State of Texas for penalties for the alleged violations of law." But the Circuit Court failed to give credence to the fact that The Tax Court itself recognized this statement and found ample evidence which overcame the import of that recitation. This Court said in the case of WEST v. SMITH, supra (page 270):

> " * * * where the effect of a written instrument collaterally introduced in evidence depends not merely upon its construction and meaning, but also upon extrinsic facts and circumstances, the inferences to be drawn from it are inferences of fact and not of law, and of course are open to explanation."

If the Circuit Court opinion is allowed to destroy the long established principle which favors settlements of litigation, taxpayers, no matter how vexatious or how many business reasons may dictate otherwise, will be forced to litigate a charge against them which might be interpreted to be of such a nature as to constitute a penalty payment because that will be the only way left open to an expenditure which can be regarded as an ordinary and necessary business expense within the purview of Section 23 (a) (1) (A) of the INTERNAL REVENUE CODE. This is not the result which the law seeks to accomplish by favoring or encouraging settlements.

It is respectfully submitted that this petition should be granted.

JAMES H. YEATMAN,
Esperson Bldg.,
Houston, Texas;

A. N. MOURSUND,
Frost Nat'l Bank Bldg.,
San Antonio, Texas